



November 2021

# Middle East Economy Watch

Recovery accelerates in GCC, despite inflation concerns

Over the last few months, COVID-19 has retreated across the GCC, even in countries that have been slower on vaccinations such as Oman and Kuwait (although they are now catching up). This, unfortunately, isn't the case across the whole Middle East—Egypt, for example, is in the midst of a fourth wave currently. However, it provides a vision of what life after COVID-19 can look like.

The turnaround has come just in time for the opening of Expo in Dubai. It is too early to judge whether the event will attract close to the 14m international tourist visitors that were originally targeted, but even half this number would represent a dramatic improvement in a vital sector.

Across the region, tourism and transport remain subdued, but most other non-oil sectors are returning to their pre-COVID-19 levels, with Saudi Arabia seeing the quickest rebound thanks to its large pool of domestic demand and spending on mega-projects.

Alongside the non-oil recovery, oil prices are at their highest sustained level since 2014

and OPEC+ is tapering its production cuts. These twin factors are helping drive a solid improvement in public finances, with the IMF forecasting that the GCC as a whole will return to a fiscal balance in 2023, for the first time since 2014. Even Oman, which was struggling with a large structural deficit before COVID-19 is seen returning to surplus next year as a result of significant reforms on top of the rebounding oil price.

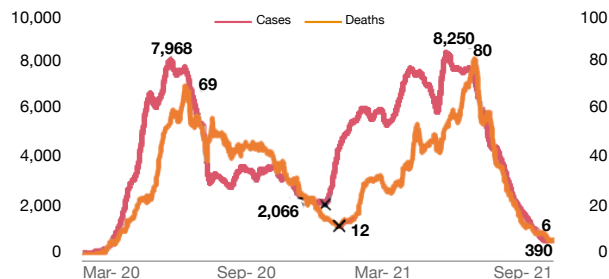
The optimism in the region is also driving a wave of major IPOs, particularly in Saudi Arabia and Abu Dhabi, with more expected soon.

There are always clouds on the horizon of course. Inflation is a major concern globally but does not appear to be too much of a worry in the GCC currently, although in Iraq it has spiked to a 9-year high.

## GCC economies rebound as COVID-19 retreats and oil surges

In the last few months, COVID-19 has retreated across the GCC. In early October, daily deaths had fallen to just 6 in the region of 66m people and daily cases below 400. These were the lowest rates since the first days of the pandemic, well below the previous lull in Q1 and about a fiftieth the concurrent incidence in the US, on a population-adjusted basis. The rollout of vaccines (UAE, Bahrain and Qatar are among the highest in the world), strict policies on travel and social interaction (now being relaxed in places) and the benefits of having compliant populations skewed towards young healthy migrants have all helped.

### COVID-19 incidence in GCC (7-day average)

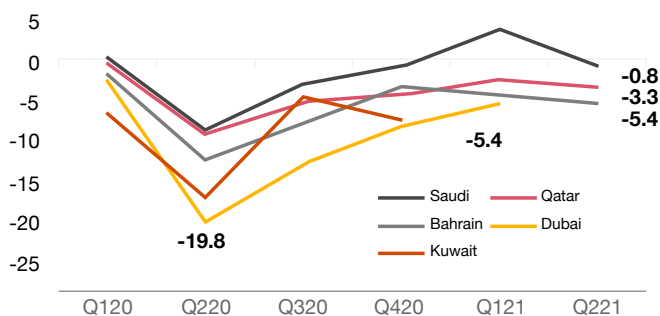


Source: WHO

### Recovery is evident in GDP, but some sectors still struggle

Even before the dramatic improvement in COVID-19 during Q3, there were clear signs of an economic rebound underway, as is visible by comparing quarterly GDP with 2019. Saudi Arabia's non-oil GDP even exceeded its pre-pandemic level in Q1, although there was a temporary step back in Q2 as a result of the Delta wave restrictions.

### Non-oil real GDP (% vs same quarter in 2019)



Source: National statistical agencies; PwC analysis

Despite the overall recovery, the most COVID-19 exposed sectors are still struggling. In Q2, hospitality was still down by -44% vs 2019 in Bahrain and -21% in Qatar. Transportation was down -29% in Qatar. By contrast, financial services have boomed across the region as central bank intervention has maintained liquidity and mitigated default risk, with the sector up by 6% vs 2019 in Saudi Arabia and 17% in Qatar. Other major sectors are largely back to their 2019 levels in most states that have reported Q2 GDP.

### Leading indicators point to a strong Q3

Leading indicators during Q3 suggest that the quarter was a strong one, and when GDP will likely have exceeded 2019 levels. The purchasing managers index (PMI), one of the best proxies for non-oil private sector activity, reached a record level of 60.6 in Qatar in September and a 7-year high of 58.6 in Saudi Arabia. It wasn't quite so strong in the UAE, but the Q3 average of 53.7 was still the strongest in over two years and far above the 50-point level that indicates economic expansion.

There were other positive signals from business confidence surveys and tourism measures. Visitor arrivals are recovering. In Qatar for example, arrivals were up by 62% month-on-month (m/m) in August to about a third of the pre-COVID-19 level. Foreign credit card transactions in Bahrain rose by 37% month-on-month (m/m) in August and comprised 18% of total point of sales by value, double the level in Q2 and not far off the 23% average in 2019. This suggests that tourists, mainly from Saudi Arabia, have returned.

## Oil production rises and prices surge

Underpinning the non-oil sector confidence is the strong rebound that is now underway in the oil sector. The strict compliance of OPEC+ members, driven by Saudi Arabia's cajoling and leadership through additional voluntary cuts, succeeded in bringing global crude inventory levels below their five-year average. At the same time demand continues to pick up as COVID-19 recedes in many parts of the world. As a result, OPEC+ has begun to taper its cuts, releasing an additional 400k barrels per day (b/d) each month bringing total production to nearly 40m b/d a month. The OPEC+ deal has been extended from April to December 2022, but GCC states should still see double-digit year-on-year (y/y) growth in oil production during 2022 because of the tapering as well as an agreement to increase the baseline levels of UAE, Saudi Arabia and Kuwait, which had lower quotas relative to their capacity than for other OPEC+ members.

Alongside rising production, GCC states are benefiting from soaring oil prices. Brent crude touched \$84 on 11th October 2021, its highest level since 2014 (bar a week-long peak in 2018) and has more than quadrupled its low in April 2020. Global gas prices have surged even further, with Asian and European spot prices touching record levels that were more than 25-times their 2020 low and equivalent to oil at over \$300 per barrel.

This has been beneficial to liquified natural gas exporters in Qatar, Oman and Abu Dhabi, and is also boosting oil demand as countries temporarily pivot their electricity generation from gas to oil.

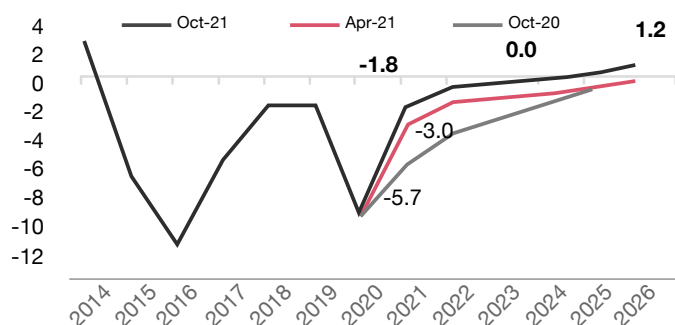
### Budgets move towards first balance since 2014

The oil market is fickle and current prices may not be sustained. However, the fiscal breakeven oil prices have declined substantially across the region, with fiscal reforms meaning that most GCC states can balance their budgets at \$70 per barrel or less, whereas in 2018 Bahrain and Oman were close to \$100 and Saudi \$90.

The IMF now forecasts an aggregated GCC general government fiscal deficit (including off-budget items, such as most sovereign wealth fund income) of just -1.8% of GDP in 2021. This compares with its forecast of -5.7% a year ago and -3.0% in April 2021. It has revised up its expectations of oil prices to Brent crude averaging \$67 per barrel this year from \$40 per barrel a year ago. The IMF's oil price assumptions are based on the futures market, which shows a gradual decline in the coming years to \$58 in 2026. The reality could be quite different, with some forecasters expecting the current prices of \$80+ to persist in 2022 while others see a sharp drop as OPEC+ boosts output and if US sanctions on Iranian exports come to an end.

If the IMF's oil assumptions hold, the GCC as a whole could return to fiscal balance in 2023, for the first time since 2014. Qatar is already in surplus, and Oman and Kuwait could return to surplus in 2022, with only small deficits in the UAE and Saudi Arabia. Bahrain is the one country where the IMF forecasts persistently large deficits, including -8% of GDP in 2022, however the forecast was made before it announced plans to double VAT and reboot its fiscal balance programme, aiming to achieve a central government balance by 2024. Meanwhile, the IMF sees GDP growth averaging 2.4% in the GCC this year, rising to 4.1% in 2022, the most since 2015.

### GCC fiscal balance (% GDP, general government, by forecast date)



Source: IMF World Economic Outlook

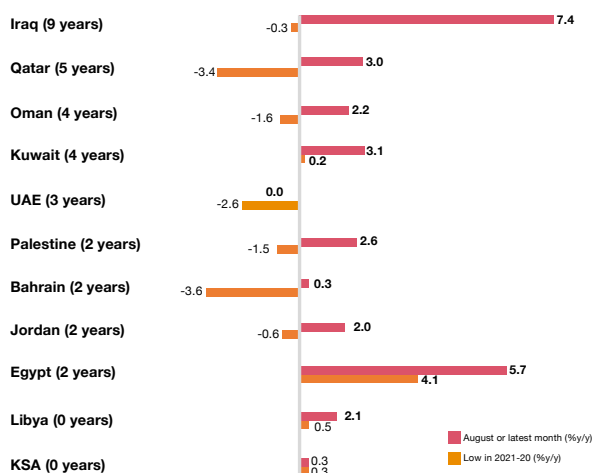
## Inflation concerns in the GCC

The flip side of a strong recovery and the rebound in oil is rising consumer prices. There are concerns globally about inflation, which has reached the highest since the 2007 spike in both the US (5.3%) and Eurozone (3.4%). There are a wide range of factors at play including the cascading impacts of temporary pandemic-related supply chain constraints, from lumber to semiconductors, and staffing shortages as people are unable or unwilling to return to their previous sectors of employment. Economists and policymakers remain divided as to whether the current global inflationary pulse will ease in 2022—as the US Fed currently believes—or could become more long-lasting.

Countries in the Middle East are exposed to these global price fluctuations because of heavy import dependence. Cuts in subsidies since 2016 also mean that most now have domestic fuel indexed to global prices. There are also localised factors at play in each country, such as high population growth in Egypt and long-running rental deflation across the GCC, which pre-dates COVID-19 but has been exacerbated by expat departures. While there have been some short-term labour constraints in the region, contributing to wage inflation, Gulf states should be able to adjust fairly easily through important new migrant workers now that COVID-19 constraints are easing.

Most countries have rebounded from the COVID-19 deflationary trend, but inflation has so far remained relatively constrained relative to historic levels in each country. Barring Lebanon, where a currency crisis is causing hyperinflation (138% in August), Iraq has the highest inflation in the region at 7.4%, the most since 2012. However, other countries are only seeing their highest levels in 2-5 years.

**Inflation** (showing recent low and years since last at current levels)



Source: National sources; July: Bahrain, Iraq, Oman, UAE; June: Libya; April: Kuwait

## Inflationary fiscal policy changes

Changes in fiscal policy have also been a factor in some countries. The tripling of the Saudi VAT rate to 15% in July 2020 sharply boosted inflation for a year, peaking at 6.2% in June 2021, the highest since 2009. However, it does not appear to have had a persistent impact, as inflation dropped sharply to just 0.4% in July 2021, roughly where it had been before the hike. The introduction of 5% VAT in Oman in April also had an inflationary impact, although slightly less pronounced in relative terms as inflation only increased by 2 percentage points that month (to 1.6% from -0.4% in March), partly because Oman implemented its VAT with a larger range of zero-rated items than Saudi Arabia did, to mitigate social hardship.

Other fiscal policy changes likely had an impact on inflation but are more difficult to attribute. Oman has been phasing in higher electricity and water prices this year and also reducing subsidies in other areas. Saudi Arabia increased a range of tariffs in July 2020, and then in July 2021, suddenly tightened its criteria for tariff-free imports from the GCC, which now excludes exports from free zones and requiring that exporting companies had a minimum of 25% GCC national employees, a difficult requirement to meet in states where expats staff over 90% of the private sector.

Looking ahead, Bahrain recently announced plans to double its VAT rate to 10%, which could come as soon as January 2022 if parliament approves the plan and will add 2pp or so to its inflation.

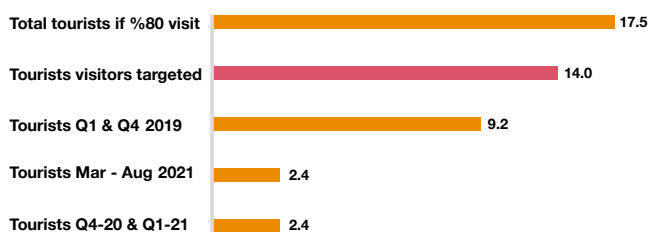
Meanwhile, Qatar and Kuwait are still considering whether to introduce VAT, but neither is likely to do so during 2022, partly because of concerns about the inflationary impact. The IMF forecasts only modest inflation in 2022, averaging 2.4% across the GCC, and then a steady 2.2% in 2023-26, close to the long-term average.

## Expo hopes

Dubai Expo opened on October 1st after a year's delay due to COVID-19. Even before the pandemic, there had been hopes that the six-month-long event would provide a boost to the economy, which had been in the doldrums due to oversupply of real estate and falling prices. The damage that COVID-19 has caused to the vital tourism sector has further added to the weight of expectations placed on Expo.

The targets announced for the event back in 2019, before the pandemic, were for 14m international tourist visitors and 11m resident visitors. However, success for the event and for Dubai does not require meeting this target.

## Expo tourists (million)



Source: Dubai Tourism; PwC estimates.

During the first ten days of the festival, there were 411,000 ticketed day visitors. If this rate were to be sustained for the whole festival, it would equate to 7.5m visitors. However, it is likely that momentum for Expo will build as the weather cools, word spreads about the Expo contents and COVID-19 concerns ease further (case rates have fallen to very low levels only in the last few weeks, too short a timeframe for most tourists to book holidays). The relaxation of travel requirements should boost tourism. The UK, traditionally one of the main tourism source markets for Dubai, only placed the UAE on its green list for quarantine-free travel on October 4th and so there could be a wave of British visitors, who in last December made Dubai-London the world's busiest international route following an earlier easing.

Most government employees (which also means most UAE nationals) are being offered a week of paid leave to attend, which is a strong incentive that will boost resident visitors. However, a large part of the UAE's 9.3m population are low-paid unaccompanied migrant workers who are unlikely to attend, despite free or subsidised tickets. So far, no breakdown has been provided in the attendance numbers between UAE residents and tourists and it may be necessary to wait until Dubai Tourism's monthly data, which is usually published about 6-8 weeks after the month-end, to see whether there has been a significant uptick in tourists in October.

Third party forecasts in 2019 had predicted that Expo would boost the UAE's GDP by 1.5%. This assumed tourist targets would be met and so the actual impact may be closer to 0.5-1% of GDP, once adjusting for actual arrivals. This will still be a welcome boost and comes at a time when Dubai's economy is expanding again and real estate prices are rising at their fastest rate since 2014, Property Monitor's Index was up 18% year on year in September to the highest since February 2019. A recent survey by Dubai Chamber found that 83% of firms surveyed expect business conditions to improve in Q4, partly because of Expo, the third-highest reading on record.

# Data and projections: November 2021

	GDP share (2021)		Real GDP growth (% y/y)			Inflation (% y/y)			Fiscal bal. (% GDP)	
	PPP	MER	Q2-21	2021p	2022p	Aug-21*	2021p	2022p	2021p	2022p
<b>Middle East</b>	<b>100%</b>	<b>100%</b>	-	<b>4.0</b>	<b>4.8</b>	<b>3.3</b>	<b>3.5</b>	<b>3.0</b>	<b>-6.1</b>	<b>-2.8</b>
<b>GCC</b>	<b>59.8%</b>	<b>70.4%</b>	-	<b>2.4</b>	<b>4.1</b>	<b>0.8</b>	<b>2.8</b>	<b>2.4</b>	<b>-5.0</b>	<b>-1.8</b>
Saudi Arabia	33.0%	35.5%	1.8	2.8	4.8	0.3	3.2	2.2	-3.1	-1.8
UAE	13.3%	17.3%	-	2.2	3.0	0.0	2.0	2.2	-0.5	-0.2
Qatar	5.2%	7.1%	4.0	1.9	4.0	3.0	2.5	3.2	2.8	5.7
Kuwait	4.0%	5.6%	-	0.9	4.3	3.1	3.2	3.0	-1.5	1.0
Oman	2.8%	3.4%	-	2.5	2.9	2.2	3.0	2.7	-2.6	1.1
Bahrain	1.5%	1.6%	5.7	2.4	3.1	0.3	1.0	2.7	-8.0	-8.0
<b>Non-GCC</b>	<b>40.2%</b>	<b>29.6%</b>	-	<b>7.6</b>	<b>6.4</b>	<b>9.3</b>	<b>5.3</b>	<b>5.3</b>	<b>-5.0</b>	<b>-4.3</b>
Egypt	26.3%	16.7%	-	3.3	5.2	5.7	4.5	6.3	-7.3	-6.3
Iraq	8.2%	8.5%	-	3.6	10.5	7.4	6.4	4.5	-1.5	-2.5
Jordan	2.1%	1.9%	3.2	2.0	2.7	2.0	1.6	2.0	-7.7	-5.9
Lebanon	1.5%	0.8%	-	-10.5	-	138.0	-	-	-3.0	-
Libya	1.7%	1.1%	-	123.2	5.3	2.1	21.1	8.0	6.8	-12.5
Palest. Terr.	0.4%	0.6%	19.0	4.4	6.0	2.6	1.3	1.7	-7.7	-6.8

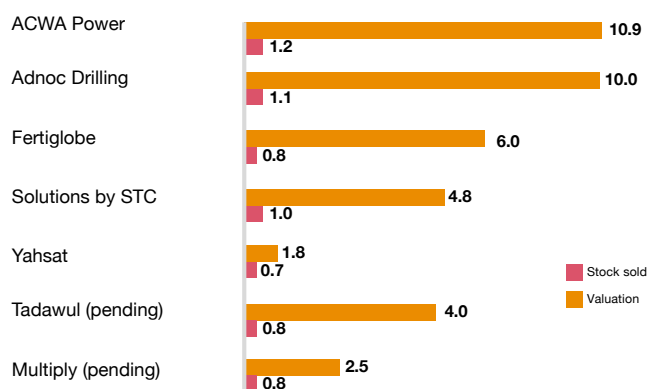
Sources: PwC analysis, National statistical authorities, IMF estimates and forecasts (WEO, October 2021). \*Older inflation series: July: Bahrain, Iraq, Oman, UAE; June: Libya; April: Kuwait; ^The IMF has temporarily suspended forecasts for Lebanon, therefore the GDP share for Lebanon is based on 2020 WEO data and the 2021 forecasts are from the World Bank.

The Middle East region is defined here based on PwC's business coverage (which excludes non-Arab countries, Syria and Yemen).

## Chart of the quarter

A surge of major IPOs is underway, particularly in Saudi Arabia and Abu Dhabi. This comes after a drought in both markets, with Saudi Arabia not seeing any substantial IPO since Aramco in 2019 and Abu Dhabi no IPOs at all since 2017. The current shift is a result of rising confidence in the region, as a result of high oil prices and the COVID-19 recovery, together with high global equity valuations. It is also due to government entities raising financing. Abu Dhabi's Mubadala kicked off the current IPO boom in July with its subsidiary Yahsat and then ADNOC listed its drilling subsidiary and fertilizer joint-venture, Fertiglobe. Royal-backed holding company IHC is now planning to IPO its tech unit Multiply. In Saudi Arabia, the Public Investment Fund is raising capital to finance its domestic giga-projects such as NEOM and tourism developments. It is the major shareholder in both Saudi Telecom, which spun off its "Solutions by STC" unit, and ACWA Power, as well as being the owner of Tadawul, whose long-postponed listing is reported to be coming soon. The three big firms that have IPOed since September have all seen their stocks surge on their first trading days, helping build demand for future IPOs.

## IPOs, recent and pending (\$bn)



Source: Tadawul and Abu Dhabi Securities Exchange

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